IN THE

Supreme Court of the United States

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OCTOBER TERM, 1952.
No. 737

HERBERT E. TOOR and FLORENCE D. TOOR,

Petitioners,

vs.

HARRY C. WESTOVER,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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HERBERT E. TOOR and FLORENCE D. TOOR,

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vs.

HARRY C. WESTOVER,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above entitled case on December 18, 1952.

Opinions Below.

The findings of fact, opinion and decisions of the District Court are reported in 94 Fed. Supp. 860, and are set forth in the record on pages 57 to 63 and 67 to 81. The opinion of the Court of Appeals [R. 520 to 530] is reported in 200 F. 2d 713.

Jurisdiction.

The judgment of the Court of Appeals was entered on December 18, 1952 [R. 531], a petition for rehearing was thereafter timely filed and the same was denied January 28, 1953. [R. 532.] The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254(1).

Questions Presented.

1. Where it is determined that the trial court has committed substantial error of law and has applied wrong standards of judgment directly and substantially prejudicing the rights of the parties, should not a reversal be directed by the Court of Appeals even though the Court is not convinced *it* would render a different judgment upon a reevaluation of the evidence in the light of proper standards?

2. May a Court of Appeals determine ultimate issues of fact on the basis of factors substantially different from those relied upon by the trial court (the trial court having committed substantial errors of law and applied wrong standards of judgment materially affecting the weight of the evidence) where such determination by the Court of Appeals does not flow *as a matter of law* from the facts relied upon?

3. In the application of the Clifford doctrine, will incidents of ownership retained by the donor of a partnership interest charge him as a matter of law with the income therefrom, regardless of whether or not the effect of such incidents is to enable the donor to retain dominion and control over the subject of the gift or the purposes for which the income from the property is used?

Statutes Involved.

The statutes involved are Sections 11, 22a, 181, 182, 3797 of the Internal Revenue Code (26 U. S. C. 1122, 181, 182, 3797). The pertinent portions of these statutes are set forth in the Appendix.

Statement of the Case.

This is a family partnership case. The complaints filed in the District Court in two actions sought the return of amounts paid with interest, as the result of additional assessments on the income tax of the plaintiffs, Mr. and Mrs. Toor, for the years 1943, 1944 and 1945. [R. 3-41.] The additional assessments were based upon the assertion that a partnership known as The Furniture Guild of California, in which Mr. Toor (hereinafter referred to as "appellant") was general partner and the Beverly Hills National Bank & Trust Company, as Trustee of two trusts, was the limited partner, was not valid for tax purposes. [R. 8, 14-15, 23.] The two cases involved identical issues and were consolidated for trial before the District Court. It was stipulated that the decision on appeal in the first case should be applied to and be decisive on the appeal from the second case. [R. 515.]

On November 20, 1942, appellant and his wife created separate trusts for their two minor children by paying $21,000.00 to the Beverly Hills National Bank & Trust Company, as Trustee under the terms of a trust instrument, providing that all funds were to be accumulated and no distribution made until the trusts terminated, which was after the children came of age. At the same time, appellant and the bank, as trustee, executed Articles of

Limited Partnership for the acquisition and conduct of a furniture manufacturing business which had previously been operated by appellant as a sole proprietorship. In accordance with this limited partnership agreement, the bank invested the sum of $20,000.00 as its capital contribution to the partnership for the two trusts. The total capital of the partnership was $60,000.00. The trust instrument expressly limited the bank to investment of trust funds in businesses in which appellant was a partner or principal stockholder or in securities of the United States or of the instrumentalities or of the states thereof. [R. 117-125, 30-40, 388-389.]

The Articles of Limited Partnership provided for payment of reasonable compensation to appellant for his services as an expense of the business; that appellant was to be general partner and the bank, as trustee, a limited partner; that profits should be divided and distributed in proportion to the investments (1/6 to each of the trusts and 4/6 to appellant), with the proviso that the profits would be distributed at times determined by the general partner; that the general partner have full power to perform all acts necessary or convenient with respect to the partnership business in accordance with the laws relating to limited partnership; that the general partner could elect to dissolve the partnership by giving 30 days prior written notice; that in the event of dissolution, the general partner could purchase the assets of the business at "book value"; that the partnership term would expire in June, 1955. [R. 30-40.]

Books were set up and properly kept on a limited partnership basis. These books fully disclosed the relationship between the partners. The parties adhered in all respects to the terms of the limited partnership agreement

and to the provisions of law relating to limited partnerships. Salary for the services of the general partner was fixed in consultation with the limited partner and paid. The books reflected the cost of all assets which, at the inception and in each instance, was the same as "book value." [R. 139-142, 388-396, 443-445, 500, 290, 338, 364, 367.] Profits were regularly and proportionately distributed. [R. 339-353, 400-401, 419.]

The District Court ruled that the partnership was not valid for tax purposes and that the Commissioner properly assessed to plaintiffs the entire income of the partnership business. [R. 76.] The ruling of the District Court was based in substantial part on its findings that the creation of the limited partnership made no change whatever in the control exercised by appellant over the business. [R. 60-61; Finding 19, R. 71; Finding 21, R. 72.]

In affirming the judgment, the Court of Appeals recognized that the District Court erred in its findings that the creation of the limited partnership made no change in the control exercised by appellant over the business, as well as in the emphasis given by the District Court to factors inherent in the usual limited partnership agreement. [R. 524-527.] However, the Court of Appeals ruled that because of certain circumstances in connection with the partnership agreement, appellant must be regarded as the substantial owner of the interests held by the limited partner and therefore that the partnership was not entitled to recognition for tax purposes. [R. 527-530.]

These circumstances relied upon by the Court of Appeals were (a) that the trust and the partnership agree-

ments were entered into together; (b) that the limited partner was neither free to transfer its interest nor to terminate the partnership until the expiration of the fixed term thereof; (c) that the appellant, as the general partner, retained powers of management, including power to make reasonable determinations regarding distribution of profits; and (d) that the general partner had power to terminate the partnership on proper notice. [R. 527-529.]

Specification of Errors.

The Court of Appeals erred:

1. In ruling that although substantial prejudicial error was committed by the trial court, it would not reverse because it was not convinced that the ultimate decision was erroneous. The Court of Appeals erroneously relied upon and misconstrued the case of *United States v. United States Gypsum Co.*, 333 U. S. 364, 68 S. Ct. 525, 92 L. Ed. 746.

2. In ruling in effect that specified circumstances would charge appellant as a matter of law with being the substantial owner of the interests of the limited partner.

3. In misapplying the *Helvering v. Clifford* doctrine by failing to evaluate and determine in the light of the principles of that case the effect of the incidents of ownership asserted to require that appellant be charged with being the owner of the capital interests of the limited partner.

4. In affirming the judgment of the District Court.

REASONS FOR GRANTING THE WRIT.

I.

In a Decision in Serious Conflict With the Decisions of This Court, With Those of the Other Circuits and With the Established Rules Governing Appeals, the Court of Appeals Has Adopted a Rule to the Effect That, Even Though a Trial Court Has Committed Material Prejudicial Error and Has Misapplied the Law, the Appellate Court Will Not Reverse so Long as the Appellate Court Is Not Convinced That the Ultimate Decision Was Erroneous.

The Court of Appeals specifically recognized that the District Court had erroneously given much weight to factors inherent in the usual partnership agreement. The Court of Appeals found that the District Court erred in finding that there was no change whatever in the control exercised by appellant over the business after the formation of the partnership.[1] The Appellate Court pointed out the distinction that the trial court had failed to observe between control exercised with unlimited discretion for one's personal benefit and control exercised in a fiduciary capacity as a general partner in a limited partnership. [R. 524 to 527.] The Court of Appeals also found the District Court to be in error in emphasizing the lack of participation in the conduct of the business by the limited partner. [R. 525.]

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[1]See Findings 19, 21 [R. 71 to 72].

The error of the District Court and the obvious importance of that error being thus recognized, it would seem that under the well-established principle of law regarding appeals a reversal would be required. The rule has been that where a trial court has committed error relating to the substantial rights of the party, a reversal will be directed unless it appears beyond doubt that the error complained of could not have prejudiced the rights of the party.

> *McCandless v. United States,* 298 U. S. 342, 347, 348, 56 S. Ct. 764, 766, 80 L. Ed. 1205;
>
> *Worcester v. Pure Torpedo Co.* (7th Cir., 1942), 127 F. 2d 945, 947.

A fortiori, where the error has materially influenced the trial court's decision and the prejudice thus affirmatively appears, it would seem clear that a reversal is required.

However, the Court of Appeals did not order a reversal in spite of the recognized substantial error committed by the trial court because, as it stated, upon an examination of the entire evidence, it was not left with a definite and firm conviction that a mistake had been committed. The Court of Appeals cited as authority for its ruling the case of *United States v. United States Gypsum,* 333 U. S. 364, 395, 68 S. Ct. 525, 542, 92 L. Ed. 746. This new rule on appeal finds no support in the *United States Gypsum* case, and its development is based upon a misconstruction and misapplication of the principle set forth in that case. In that case, it was stated:

> "A finding is 'clearly erroneous' when although there is evidence to support it the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

The quoted portion enlarged the grounds for reversal rather than narrowed those grounds. Clearly it will not support the proposition advanced by the United States Court of Appeals for the Ninth Circuit that a finding is not "clearly erroneous" in spite of recognized material error so long as the Appellate Court is not convinced that the final result was wrong.

Nor can it be argued that such is not the proposition advanced by the Court of Appeals; its opinion and reasoning will admit of no other conclusion. It had *already* determined the trial court erred and misapplied the law in arriving at material findings which substantially affected the final result; nevertheless it went on to say that it would not reverse because it felt on an examination of the entire evidence that no mistake was committed. The mistake referred to could only be in the ultimate decision since material error had previously been found in the findings.

Clearly a decision establishing such a proposition in conflict with the decisions of this Court and of the other circuits is of such vital importance as to call for review and correction by this Court.

II.

The Court of Appeals Usurped the Function of the Trial Court as the Trier of the Facts.

Although the Court of Appeals recognized that it was for the trial court to determine the issues of fact, such recognition was in the form of lip service only.

The trial court, in finding a lack of intention to enter into the present conduct of the business enterprise, relied in substantial part upon its finding in effect that appellant was the owner of the capital invested in the business by the limited partner.[2] In this finding, the trial court specifically stated it was so finding because of the control of appellant over the corpus and income *as well as* because of retention of other attributes of ownership of the trust corpus. It is without question that the trial court, in arriving at its ultimate conclusion, relied upon a cumulation of factors. As was conceded by the Court of Appeals, it is clear that the trial court was erroneously and substantially persuaded by its improper view that the creation of the partnership made no change in the control exercised by appellant as well as by the emphasis the trial court placed on the fact that the limited partner did not actively participate in the conduct of the business.

It is obvious that a re-evaluation of this case by a trial court in the light of a proper application of the principles of law could certainly bring about a different result and a different determination by the trier of facts. It is not for the Appellate Court to determine the weight of the evidence. It is not for the Appellate Court to say which

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[2]Finding 24. [R. 72.]

of the substantial factors were most persuasive in the mind of the trier of facts. In short, it is not for the Appellate Court to determine which straw did or did not break the camel's back. This rule that the reviewing court does not review the evidence as an original fact-finding tribunal has been the prevailing view in the other Circuits as well as in this Court.[3]

As stated by Mr. Justice Frankfurter in his concurring opinion in *Commissioner v. Culbertson,* 337 U. S. 733, 749, 69 S. Ct. 1210, 1218, 93 L. Ed. 1659:

> "The Court finds that the Tax Court applied wrong legal standards in determining that the arrangement in controversy did not constitute a partnership. It remands the case to the Tax Court because it is for *that court, and not for the Court of Appeals, to ascertain, on the basis of appropriate legal criteria,* the existence of a partnership within the provisions of Int. Rev. Code, Secs. 181 and 182, 26 U. S. C. A., Secs. 181, 182." (Emphasis added.)

In conflict with these decisions, the Court of Appeals here went on to determine independently, on the basis of a portion only of the factors relied upon by the trial court in reaching its conclusion, that the appellant would be regarded as the substantial owner of the capital invested in the business by the limited partner. The factors relied upon by the Court of Appeals did not as a matter

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[3]*Commissioner v. Culbertson,* 337 U. S. 733, 69 S. Ct. 1210, 93 L. Ed. 1659; *Darnell v. Darnell* (D. C. Cir., 1952), 200 F. 2d 747, 749; *Gallagher v. Philadelphia Transp. Co.* (3rd Cir., 1950), 185 F. 2d 543, 547; *Campana Corporation v. Harrison* (7th Cir., 1940), 114 F. 2d 400, 405. See, also: *Pendergrass v. New York Life Insurance Co.* (8th Cir., 1950), 181 F. 2d 136, 138; *Widney v. United States* (10th Cir., 1949), 178 F. 2d 880, 884.

of law compel the conclusion reached by that court. The Court of Appeals has here weighed the evidence, independently arrived at its own conclusion and usurped the function of the trial court.

III.

The Court of Appeals Misconstrued and Misapplied Both the Helvering v. Clifford and Commissioner v. Culbertson Cases.

The Court of Appeals, citing *Helvering v. Clifford,* 309 U. S. 331, 60 S. Ct. 554, 84 L. Ed. 788, rests its affirmance of the judgment on its conclusion that certain asserted incidents of ownership would cause appellant to be regarded as the substantial owner of the interests in the partnership belonging to the limited partner. There is no reference to sham, mere paper transaction or bad faith in this case and none was present.

In arriving at its conclusion the Court of Appeals misconstrued and misapplied the cases of *Helvering v. Clifford, supra,* and *Commissioner v. Culbertson, supra.* To charge a donor with being the substantial owner of interests conveyed under the doctrine of these cases, it is not enough merely to recite that the donor has retained incidents of ownership, as did the Court of Appeals here. Every partnership, and particularly a limited partnership, formed by a binding agreement involves the giving up of rights or "incidents of ownership" by the contracting parties. Those "incidents of ownership" must be evaluated and appraised to see if actually they do amount to the retention of a control so complete that the donor is still in practical effect the owner of the income. In other words, has the change in ownership failed to disturb in the least the dominion and control over the subject of

the gift or the purposes for which the income of the property is used—is the donor able to retain the substance of full enjoyment of all the rights which previously he had in the property?

Commissioner v Culbertson, 337 U. S. 733, 746, 69 S. Ct. 1210, 1216, 93 L. Ed. 1659.

Analyzing each one of the incidents of ownership upon which the decision of the Court of Appeals is based, we find that neither individually nor collectively are they sufficient to meet the fundamental test for the application of the Clifford principle.

1. That the Trustee Received the Conveyance in Trust and the Limited Partnership Arrangements, All as "One Package."

This is entirely true and appellant will concede that the transaction had the same effect as if appellant made a gift in trust of the interests in the limited partnership. But we are here concerned only with the reality of the ownership of the partnership interests—not with the money used to purchase them. That a donee has no choice of what he is to receive, whether it be money or property, does not make him any less the owner of what he eventually actually gets. Take an illustration of a father who, instead of giving his son a car, gives him $3,000.00 with the proviso that he must buy a car which is manufactured by the father's company. We do not feel that it could logically be argued that, because of the proviso, the son does not own the car he bought with the money.

2. That the Limited Partners Could Not Terminate or Transfer Their Interests During the Fixed Term of the Partnership.

Because the bank could not terminate or transfer its interest during the fixed term of the partnership, the Court of Appeals ruled that it never "acquired such control as that which constitutes the usual attribute of property ownership." Again, the Court overlooked legal incidents and practical realities inherent in a limited partnership arrangement composed of a small group, whether it be family or otherwise; the attribution of tax significance to such factor is a further demonstration of "at best an error in emphasis" on the part of the Court of Appeals.

As a practical business and legal relationship it is only normal in a small partnership group that interests be made non-assignable and no significance can be attached to that fact. A partnership of a small group of persons in theory and in fact creates a personal relationship which does not permit substitution, and one normally has the right to choose his partners. It is to be noted that in the instant case, the interest of the appellant as general partner was also specifically made non-assignable.

When a limited partner enters a partnership for a fixed term, he, by the very definition of a limited partnership, surrenders control; as the Court of Appeals has pointed out in its opinion "it is fundamental to a limited partnership that the limited partners have no part in the control or management of the business." The Bank acquired

exactly the same control as any limited partner in a limited partnership for a fixed term.[4] It must also be borne in mind that by such surrender of control by the limited partner, the general partner does not acquire full control but only acquires the control of a fiduciary to manage partnership affairs.

In the light of general business and legal experience, a partnership which by agreement provides for its continuation for a period of years is the usual case and not the unusual. Certainly no tax significance can result from the fact that a limited partnership is one for a term of years.

Moreover, as a practical matter, the function of a limited partner is generally limited to the contribution of capital for the use and benefit of a partnership for a fixed period of time. It would be highly unusual and completely impractical to allow limited partners to withdraw their capital from a going business at will.

3. That as General Partner, Appellant Had Discretion With Respect to the Distributions of Profits.

Under the law and in the absence of specific provision with respect thereto, a general partner has the power to make reasonable determinations regarding distributions of profits. This power was specifically confirmed to appellant in the partnership agreement, with the added

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[4]The Court of Appeals recognized that a limited partnership may be valid for tax purposes even where a family relationship is involved, citing *Lamb v. Smith* (3rd Cir., 1950), 183 F. 2d 938; *Greenberger v. Commissioner* (7th Cir., 1949), 177 F. 2d 990. [R. 527.]

proviso that the distributions had to be in proportion to the respective investments of the partners and profits were regularly and proportionately distributed. The Court of Appeals erred in attaching determinative tax significance under the *Clifford* doctrine to this fact.

It is highly illogical that a provision in an agreement giving the appellant no more rights than he would have had without such provision should be made the basis for a conclusion that appellant was the substantial owner of the interest belonging to the limited partner. The Court of Appeals has apparently overlooked the fact that appellant could not derive any personal benefit from a failure to distribute profits. He could not utilize such profits for his own personal uses or benefit. Any benefit or advantage accruing from allowing profits to remain in the business would accrue proportionately to all of the partners. As with respect to corpus, the distinction must likewise be observed here between control for one's own personal benefit and control exercised in a fiduciary capacity as general partner. Appellant's sole control over the income was in a fiduciary capacity as general partner in the business and he could not distribute to himself more than his proper share of the profits nor could he benefit personally from the profits accruing to the limited partners. In this respect, it is felt that the following concluding comment of the trial court was most significant [R. 500]:

> "I will say this for you: I intimated a prospective finding of fact on one point, and I will intimate to you another prospective finding of fact, which is to your advantage, and that is this: that the evidence shows clearly that the estate, the partnership, respected at all times the rights and interests of the

trusts, and at no time was there any attempt to deprive these children of the benefits coming to them.

"The only thing that may appear in the record so far is the fact there may be undistributed profit which, of course, it is within the right of a partnership or corporation to distribute at a particular time. In that respect we do not have a paper organization. If it were paper it would have accumulated a lot of good money of the United States in the trust of each of those children over this period of years. So that to that extent the evidence is absolutely clear, that once the partnership was established, all the benefits that could go into that trust actually went into that trust. There were no kickbacks."

4. That the General Partner Had Power to Terminate the Partnership on Certain Notice.

The provision in question merely gave the general partner the power to terminate; it was in no sense a power of revocation. Upon such termination, appellant could only acquire the assets of the business by paying full book value therefor which would include all accrued profit. Certainly, one would not expect that the distribution of the assets of a furniture factory would be made in kind upon termination or otherwise. There was no finding that the book value was an improper valuation at the time the agreement was executed or at any other time. The power of termination given in the agreement was in no sense a surrender by the bank of any element of ownership of the interests of the limited partners in the partnership; it gave appellant the power to terminate the partnership but he could not deprive the limited partners of any portion of their ownership

interests or profits and there were sound business reasons for such provision. [R. 383.]

Due to confusion in the application of the *Clifford* doctrine to trusts, the Bureau of Internal Revenue has attempted to set up more precise guides for the application of the principle in the trust field.[5] These guides appear to be applicable to the partnership situation since the basic underlying principle is the same. Analyzing the above factors relied upon by the Court of Appeals in the light of these guides, we find that they clearly do not call for the application of the *Clifford* doctrine in this case. It is without contradiction that (a) the corpus or income therefrom could never return to appellant; (b) the beneficial enjoyment of the corpus or income therefrom was not subject to any power of disposition, whether by revocation, alteration or otherwise exercisable by appellant; and (c) neither the corpus nor the income therefrom was subject to administrative control exercisable primarily for the benefit of appellant; as pointed out, his administrative control was limited to that of a fiduciary acting for the benefit of the limited partner.

As contrasted with the *Clifford* case, the economic relation of appellant in the instant case to the income in question had changed and he definitely was poorer after the partnership was formed. He had forever parted with the ownership, as well as dominion and control for his own purposes, of 2/6 of the partnership business and had

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[5]See Regulations 111, Section 29.22(a)-21, the pertinent portions of which are set out in the Appendix.

forever parted with the right to receive or benefit from the income therefrom.[6] Nor is this case comparable to the situation in that of *Commissioner v. Tower*, 327 U. S. 280, 66 S. Ct. 532, 90 L. Ed. 670, where the income in question was used for the donor's purposes just as it had been before the formation of the partnership.

In any event, whether or not the factors relied upon by the Court of Appeals *could* support a finding that the appellant remained the substantial owner of the capital interests of the limited partners, those factors do not *require* such a finding *as a matter of law*. Yet this is precisely the effect of the ruling of the Court of Appeals. It has held that those factors or circumstances must charge appellant with the ownership of the capital belonging to the limited partners, even though it was conceded that the trial court relied on other factors and applied wrong legal principles in reaching a similar conclusion.

The importance of the application of the *Clifford* doctrine to family partnership cases is evident not only in

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[6]The following language in *Commissioner v. Culbertson*, 337 U. S. at 746, 69 S. Ct. at 1216 (footnote 16) is directly applicable to the instant case:

"It is not enough to say in this case, as we did in the Clifford case, that 'It is hard to imagine that respondent felt himself the poorer after this [partnership agreement] had been executed or, if he did, that it had any rational foundation in fact.' 309 U. S. at page 336, 60 S. Ct. at page 557, 84 L. Ed. 788. Culbertson's interest in his partnership with Coon was worth about $50,000 immediately prior to dissolution of the partnership. In order to sustain the Tax Court, we would have to conclude that he felt himself worth approximately twice that much upon his purchase of Coon's interest, even though he had agreed to sell that interest to his sons at the same price."

cases arising before the Revenue Act of 1951[7] but in cases arising under that Act as well.[8]

The decision in the instant case sets forth a dangerous and erroneous rule whereby a court may point to so-called incidents of ownership as grounds for changing tax consequences without a proper evaluation of the effect of those incidents on the control exercisable by the donor for his own purposes of the capital in question. The error in this rule is compounded and aggravated when the rule is utilized, as in this case, to permit an appellate court to say that the presence of such unevaluated incidents requires a change in tax consequences as a matter of law regardless of errors committed by the trial court in arriving at its conclusion. It is respectfully submitted that the decision is in serious conflict with the decisions in *Helvering v. Clifford, supra,* and *Commissioner v. Culbertson, supra,* and should be reviewed and corrected by this Court.

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[7]*Commissioner v. Culbertson, supra.*

[8]The Revenue Act of 1951, in an attempt to clarify the law, made specific provisions with respect to family partnerships. Those provisions are set out in the Appendix. However, the problem of the application of the *Clifford* doctrine remains. As stated in the Committee Reports on the Revenue Act of 1951:

"The amendment leaves the Commissioner and the courts free to inquire in any case whether the donee or purchaser actually owns the interest in the partnership which the transferor purports to have given or sold him. Cases will arise where the gift or sale is a mere sham. Other cases will arise where the transferor retains so many of the incidents of ownership that he will continue to be recognized as a substantial owner of the interest which he purports to have given away, as was held by the Supreme Court in the case of Helvering v. Clifford (309 U. S. 331)." Sen. Rep. No. 781, 82nd Cong., 1st Sess., Sec. VI A 7 (1951); H. R. Rep. No. 586, 82nd Cong., 1st Sess., Sec. V M (1951).

Conclusion.

For the foregoing reasons, this petition for a Writ of Certiorari should be granted

Respectfully submitted,

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APPENDIX.

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

(26 U. S. C. A., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.* — "Gross income" includes gains, profits and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *.

(26 U. S. C. A., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. A., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * * * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U. S. C. A., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * * * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * * * * * *

(26 U. S. C. A., Sec. 3797.)

Revenue Act of 1951:

SEC. 340. FAMILY PARTNERSHIPS.

(a) *Definition of Partner.* — Section 3797(a)(2) is hereby amended by adding at the end thereof the following: "A person shall be recognized as a partner for income tax purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person."

(b) *Allocation of Partnership Income.*—Supplement F of chapter 1 is hereby amended by adding at the end thereof the following new section:

"Sec. 191. Family partnerships.

"In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service. For the purpose of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The 'family' of any individual shall include only his spouse, ancestors, and lineal descendants, and any trust for the primary benefit of such persons."

"(c) *Effective Date.*—The amendments made by this section shall be applicable with respect to taxable years beginning after December 31, 1950. The determination as to whether a person shall be recognized as a partner for income tax purposes for any taxable year beginning before January 1, 1951, shall be made as if this section had not been enacted and without inferences drawn from the fact that this section is not expressly made applicable with respect to taxable years beginning before January 1, 1951."

BUREAU OF INTERNAL REVENUE REGULATIONS 111.
(26 C. F. R. 29.22(a)-21.)

Regulation, Section 29.22(a)-21 reads in part as follows:

(a) *Introduction.*—Income of a trust is taxable to the grantor under section 22(a) although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. (*Helvering v. Clifford,* 309 U. S. 331.) In the absence of precise guides supplied by an appropriate regulation, the application of this principle to varying and diversified factual situations has led to considerable uncertainty and confusion. The provisions of this section accordingly resolve the present difficulties of application by defining and specifying those factors which demonstrate the retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under section 22(a). Such factors are set forth in general in paragraph (b) and in detail in paragraphs (c), (d) and (e), below.

(b) *In General.*—In conformity with the principle stated in paragraph (a) above, the income of a trust is attributable to the grantor (except where such income is taxable to the grantor's spouse or former spouse under section 22(k) or 171) if—

(1) the corpus or the income therefrom will or may return after a relatively short term of years (see paragraph (c));

(2) the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition

(other than certain excepted powers), whether by revocation, alteration or otherwise, exercisable by the grantor, or another person lacking a substantial adverse interest in such disposition, or both (see paragraph (d)); or

(3) The corpus or the income therefrom is subject to administrative control, exercisable primarily for the benefit of the grantor (see paragraph (e)).

* * * * * * * * *

(e) *Administrative Control.* * * * If a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. Such presumption may be rebutted only by a clear and convincing proof that the power is not exercisable primarily in the interests of the beneficiaries. * * *

RULE 52(a), FEDERAL RULES OF CIVIL PROCEDURE.
(28 U. S. C. A., Rule 52.)

* * * Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. * * *

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255528—53

In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 737

HERBERT E. TOOR AND FLORENCE D. TOOR,
PETITIONERS

v.

HARRY C. WESTOVER

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 57–63) is reported at 94 F. Supp. 860. The opinion of the Court of Appeals (R. 520–530) is reported at 200 F. 2d 713.

JURISDICTION

The judgment of the Court of Appeals was entered on December 18, 1952. (R. 531.) The taxpayers' petition for rehearing, filed on January 19, 1953, was denied on January 28, 1953. (R. 532.) The petition for a writ of certiorari was filed on April 22, 1953. The jurisdiction of

this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the court below correctly affirmed the District Court's determination that the taxpayers and the bank, as trustee for their two minor children, did not intend in good faith to carry on the taxpayers' business as bona fide partners during the taxable years 1943 through 1945, and, therefore, that the share of the business income attributed to the bank as a partner was includible in the taxpayers' gross income for those years.

STATUTE INVOLVED

These are printed in the Appendix, *infra*, pp. 10–11.

STATEMENT

In two suits for recovery of additional amounts assessed against them as income taxes for the years 1943, 1944, and 1945, petitioners contended that the Commissioner had erred in determining that a family partnership arrangement for the benefit of their two minor children was invalid for tax purposes.[1] The pertinent facts were found by the District Court as follows (R. 70–73):

[1] The two suits presented identical issues, and the court below, acting on a stipulation of the parties, ordered that both should be determined by the decision in *Herbert E. Toor* v. *Westover*, No. 10461–Y in the District Court. (R. 515–516.) Since the wife is a party only because of her community property interest, the term "taxpayer" will be used here for convenience to refer to the husband unless otherwise specified.

On November 20, 1942, the taxpayer, as manager of his marital community's property, entered into two trust agreements with the Beverly Hills National Bank and Trust Company, as trustee (hereinafter called the bank or trustee), to create trusts for his two minor children.[2] At the same time, the taxpayer and the trustee executed articles of limited partnership for the sharing of the profits of a furniture manufacturing business theretofore operated by the taxpayer under the name of the Furniture Guild of California. The trust and limited partnership agreements were presented to the bank by the taxpayer as one package. (R. 70.)

Each trust was in the sum of $10,500. The trustee was authorized to invest the trust funds only in businesses in which the taxpayer was a partner or principal stockholder, or in Government bonds. In each trust deed the taxpayer reserved the power to remove the trustee and put another in its place, without limitation. (R. 70.) The trust instruments contained no statement that they were not revocable by the grantors. It was not until January 13, 1944, that there were executed amendments to the trust instruments which stated that they were not so revocable. (R. 70–71.)

[2] The record shows that the taxpayer's wife was co-signer with him in the original trust agreements (R. 117–127), as well as in the subsequent amendments thereto. (R. 176–180, 358–361, 522.)

Under the articles of limited partnership, the taxpayer was declared to be a general partner, and the bank as trustee was declared to be a limited partner. The partnership was not to terminate until 1955, and the interest of the limited partner was not to be transferable. The taxpayer, however, had the right to terminate the arrangement upon giving a thirty-day notice of intention to dissolve it, and he had the absolute right to purchase the interest of the limited partner at "book" value. The taxpayer, under the partnership agreement, retained full charge and control of the entire business, and had full power and authority to do any act necessary or convenient with respect to the business. While under the agreement the business profits were to be divided on the books in the ratio of one-sixth to each trust and four-sixths to the taxpayer, he had the right to distribute the profits at such times and in such amounts as he determined. (R. 71.)

The trustee contributed neither independent money nor services during the existence of the partnership. (R. 71.) The control of the business income and the manner of its allocation, the salaries to be received by the taxpayer and the employees, the amount to be paid for the rental of the taxpayer's property on which the business was carried on—in brief, the determination of all matters requiring judgment of management, control of the property, the disposition and alloca-

tion of funds derived from the business, including amounts to be allocated each year, were so exclusively under the domination of the taxpayer that, to all intents and purposes, the creation of the partnership made no change whatever in the manner in which the business had been conducted before. (R. 72.)

No instance appears where the bank or its representatives used independent judgment or suggested any action other than that proposed by the taxpayer. The trustee exercised none of the rights of partnership even by way of advice. The trustee did not exercise dominion and control over the trust corpus in the business and did not influence the conduct of the partnership or the disposition of its income. (R. 72.)

The nature of the business was such that the taxpayer's personal services, business judgments and skill played an important role in the earning of the business income. But to the extent that capital played a part, because of his control over the corpus and income and his retention of so many of the attributes of ownership of the trust corpus in his business, the taxpayer must still be considered to have created the entire business income. (R. 72.)

The entire effect of the establishment of the partnership was merely to permit the taxpayer's children to receive a certain amount of the income when he determined that the income was

subject to distribution rather than diversion to other business determined by him. (R. 72–73.)

The taxpayer and the trustee did not act with a business purpose in setting up the limited partnership. The taxpayer and the trustee did not in good faith intend to join together in the present conduct of the business enterprise. (R. 73.)

Upon the basis of these facts, the District Court held that the parties were not bona fide partners for income tax purposes during the taxable years involved, and therefore the entire income of the business was properly assessed by the Commissioner of Internal Revenue against the taxpayer and his wife on a community property basis. The Court of Appeals affirmed.

ARGUMENT

This case presents no question requiring further review by this Court. Far from creating any conflict of decisions, the decision below is simply a correct application of the settled principle that an anticipatory assignment of income, whatever its formal cloak, is ineffective as a means of shifting tax liability. *Lucas* v. *Earl,* 281 U. S. 111; *Helvering* v. *Clifford,* 309 U. S. 331; *Helvering* v. *Horst,* 311 U. S. 112; *Helvering* v. *Eubank,* 311 U. S. 122; *Harrison* v. *Schaffner,* 312 U. S. 579; *Commissioner* v. *Tower,* 327 U. S. 280; *Lusthaus* v. *Commissioner,* 327 U. S. 293; *Commissioner* v. *Sunnen,* 333 U. S. 591; *Commissioner* v. *Culbertson,* 337 U. S. 733.

The taxpayer's contention that the bank, as trustee for his two minor children, was a bona fide limited partner in his business is premised upon the purported purchase by the bank of a partnership interest with funds transferred to the bank by the taxpayer and his wife.[3] But it has never been suggested that these mere forms of gift and purchase are sufficient in themselves to constitute a partnership for tax purposes. And both courts below, fully supported by the record, have found that the taxpayer—because of the control he retained over the trust corpus and income, remaining for all practical purposes the real owner of the partnership business and creator of its income—was properly taxed on the entire partnership income.

The District Court, in findings which are not attacked here, found (R. 70–73) that the taxpayer, sole proprietor of the business, presented the trust and limited-partnership agreements to the bank in 1942 as a single package; the bank, as trustee, was required to enter into the partnership as a condition for creation of the trust. Once in the partnership, the bank could neither terminate nor transfer its interest. The partnership was not to terminate until 1955, but the taxpayer reserved the power to terminate the arrangement at any time upon giving thirty days' notice or by

[3] There is no contention that the trustee—or the minor children who were beneficiaries of the trust—contributed any services to the partnership. (R. 72.)

purchasing the interest of the trustee at its book value. The taxpayer retained all powers of management and control over the property and determined the disposition and allocation of funds derived from the business. The parties, in short, "did not act with a business purpose in setting up the limited partnership." (R. 73.)

On these unquestioned findings, we submit, the court below was clearly correct in concluding (R. 529) that the taxpayer "remained the substantial owner of the interest he purported to have given away." Conceding that even a limited partnership involving a family relationship may be valid for tax purposes, and recognizing the restricted role of a limited partner, the court below disapproved the District Court's view that "the creation of the limited partnership made *no change whatsoever* in the manner in which the business had been conducted before." (R. 524–525; emphasis added.) But this modification in emphasis leaves intact the dispositive conclusion, on which both courts agreed, that the taxpayer never conferred upon the bank the kind of substantial ownership required to justify shifting to the bank as a "partner" a portion of his income tax liability.

Nor is there any merit in the contention (Pet. 6, 7–9) that this single subsidiary point of divergence between the courts below somehow creates a question warranting review by this Court. Sharing the view that the taxpayer had not as a

matter of fact created a genuine partnership, the court below merely disagreed with the district court's more sweeping conclusion that there had been "no change whatsoever" in the taxpayer's method of conducting his business. The Court of Appeals made no new findings of fact; on the contrary it approved, following examination of the record, the District Court findings it held to be "crucial" (R. 529). Whatever shades of difference there may have been in the lines of reasoning followed by the courts below, there is clearly no basis for the suggestion, built by petitioners upon wholly irrelevant precedents, that the court below was required to reverse the decisive findings and conclusion with which it agreed.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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Assistant Attorney General.
ELLIS N. SLACK,
S. DEE HANSON,
Special Assistants to the Attorney General.

MAY 1953.

APPENDIX

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax * * *.

(26 U. S. C. 1946 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U. S. C. 1946 ed., Sec. 182.)

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* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1946 ed., Sec. 3797.)

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